

Early Neutral Evaluation Can Diffuse Reps And Warranty Disputes

By **Jason Dubner and Mark Schwartz** (June 14, 2018, 3:32 PM EDT)

According to American Insurance Group's 2018 Global M&A Claims Study, nearly one in five of the carrier's representations and warranties insurance, or RWI, policies covering policy years 2011-2016 has now received a claim notification, and that number continues to rise with each moving five-year period. With an influx of new carriers to the market, softening rates and broadening coverage, the success of the industry as a whole will thus depend upon the ongoing development and adoption of reasonable and efficient claims handling processes, including optimal dispute resolution mechanisms.

Most RWI policies require that any dispute arising out of the policy be resolved through arbitration. Typically, the arbitration clause necessitates that the dispute be submitted to arbitration under the rules of the American Arbitration Association or another comparable dispute resolution organization, before either a single arbitrator or a three-arbitrator panel. In an ideal world, arbitration offers both the insured and the insurer a potentially confidential, relatively expeditious approach to resolving their dispute before an arbiter who has knowledge of, and experience with, the corporate and insurance-related concepts relevant to the matters at issue. But arbitration has potential downsides as well. Depending on the nature of the insured's claim and the arbitrator's — or arbitrators' — philosophy, arbitration may result in the imposition of discovery limitations that prevent necessary fact-finding; the creation of inefficient satellite disputes (e.g. with regard to arbitrator selection, scheduling, etc.); the rendering of unappealable, unprincipled rulings designed to give some benefit to all parties (i.e., "splitting the baby"); and a fracturing of the relationships between all involved.

To avoid the risks and other potential negative aspects of arbitration, parties often attempt a mediated resolution of their dispute. Mediation can be a useful tool to bridge the gaps between the parties, and has been effective in facilitating settlement of RWI claim disputes. Indeed, some commentators opine that as many as 75 percent of commercial disputes are settled with the help of mediation. But a mediator's focus is not on predicting the outcome of the ultimate merits of the dispute. While an unquestionably valuable tool in many instances, mediation does not always succeed in facilitating a settlement.

As an alternative (or precursor) to mediation or arbitration, parties involved in RWI claims disputes



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should consider an ADR tool known as “Early Neutral Evaluation” or “ENE.”^[1] ENE generally involves the following five steps:

Step 1: After electing ENE, the parties identify a neutral evaluator. This can be accomplished by various means, including by selecting from a list of candidates provided by the AAA who possess an agreed upon set of required qualifications.

Step 2: Once an evaluator is chosen, the parties submit and exchange initial written statements, which describe the substance of the dispute, the parties’ views of the key liability and damage issues, key evidence and any other information requested by the evaluator.

Step 3: Next, an evaluation session is scheduled, where each party informally presents its claims and defenses, including the primary evidence on which those are based. To facilitate an open exchange of information, the parties should agree that any views expressed or admissions made during the evaluation session (and in the parties’ initial written statements) will not be admissible as evidence — and that the evaluator will not be compelled to testify or provide information — in any subsequent proceedings.

Step 4: Generally within a few weeks after the evaluation session, the evaluator provides the parties with her evaluation of the merits of the claim and/or quantum of the alleged loss in a nonbinding report containing the evaluator’s unbiased opinions on the case. In contrast with mediation, the evaluator does not attempt to facilitate a negotiation between the parties, but rather provides a neutral case assessment for the parties to consider.

Step 5: Based on insight obtained through the evaluation, the parties decide whether to proceed with settlement negotiations, mediation, arbitration, or — if the policy provision allows — in-court litigation.

The primary advantage that early neutral evaluation offers is the opportunity for both the insured and the insurer to get an early, unbiased assessment of the merits of the claim. Unlike a mediator, the neutral evaluator is tasked with assessing the merits of the dispute and informing the parties of the evaluator’s view of the probable outcome should the case proceed to arbitration (or litigation). Though not binding on the parties, obtaining an evaluator’s assessment of the dispute provides the parties with a useful reality check on their respective chances of success. Without ENE, such a reality check on the parties’ expectations is often difficult to obtain.

Of course, early neutral evaluation might not be right for every RWI claims dispute. For example, in disputes involving smaller claims, the additional time and expense of engaging in ENE might not be justified. In addition, because of the inherent information disparity at the outset of the claim handling process, ENE will not succeed unless both insured and insurer are prepared to fully and openly disclose the relevant facts and documents, both in their written statements and as part of the evaluation session. Finally, as with mediation or arbitration, ENE has the potential to generate satellite disputes in connection with the selection of the evaluator or the timing of the process.

Notwithstanding those issues, parties involved in RWI claims disputes should consider early neutral evaluation in appropriate cases because the ability to obtain an early neutral assessment of the case might, in turn, lead to a settlement that more accurately reflects the value of an insured’s claim and the insurer’s true exposure.

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[1] See generally “Early Neutral Evaluation: Getting an Expert’s Assessment,” available at https://apps.adr.org/cs/idcplg?IdcService=GET_FILE&dDocName=ADRSTG_003837&RevisionSelectionMethod=LatestReleased; see also “Early Neutral Evaluation (ENE),” available at <https://www.cand.uscourts.gov/ene> (describing the Early Neutral Evaluation program used in federal court in the Northern District of California as governed by ADR Local Rule 5).